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No. 85-554

In the Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA, PETITIONER

v.

HUGHES PROPERTIES, INC.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

REPLY MEMORANDUM FOR THE UNITED STATES

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1. Respondent concedes (Br. in Opp. 9, 21) that the circuits are squarely in conflict on the question presented. Respondent appears to agree with our contention (Pet. 15-16) that this question is an extremely important one for the gaming industry, involving something like $70 million in tax revenues for that industry alone. And respondent does not dispute our contention (Pet. 16) that the decision below, rendered by a court of nationwide jurisdiction, may have an even greater impact outside the gambling business, permitting taxpayers to claim current tax deductions for all sorts of contingent future losses. Indeed, respondent defends the decision below by citing cases involving accruals of deductions for such diverse items as workmen's compensation claims, payments to profit-sharing plans, duties under service contracts, and obligations to restore strip-mined land (Br. in Opp. 10, 14, 18-19). In short, respondent has said nothing to contradict our submission that the

circuits are in conflict on an important question meriting this Court's review.

2. Respondent devotes almost its entire brief (Br. in Opp. 6-20) to an elaboration of its contention that the decision below is correct and that the Ninth Circuit's conflicting decision in *Nightingale* v. *United States*, 684 F.2d 611 (1982), was "wrongly decided" (Br. in Opp. 9, 21). We think that this contention can best be debated in briefs on the merits. A few points, however, warrant a short reply now:

a. Respondent characterizes our argument as permitting the deduction of progressive jackpot liabilities only upon their "actual payment," and asserts that the effect of our position is irrationally to place it, an accrual-method taxpayer, on the cash method of accounting for such deductions (Br. in Opp. 5, 13). This characterization is incorrect. Our position is that respondent cannot accrue a deduction for its progressive jackpots until somebody actually wins them. The event that converts respondent's offer of a jackpot into a fixed liability, and which is thus a sine qua non of deductibility under the "all events" test, is the winning pull of the slot machine handle. Once that event has occurred, respondent may properly accrue a deduction regardless whether it writes the gambler a check for his winnings at once, or defers payment until the next day or the next year. Except in the situation (probably rare) where the casino contests its liability to the winning customer, the time and mode of actual payment are irrelevant.

b. Respondent reiterates its contention that its liability to pay a progressive jackpot becomes "fixed" the moment a machine is placed on the floor, and asserts that the IRS seeks improperly to deny it a deduction because of such "remote possibilities" as its becoming bankrupt or ceasing to do business (Br. in Opp. 6, 11). This argument again misstates our position. What prevents respondent from

accruing a deduction is not the possibility that it might avoid paying the jackpots by entering bankruptcy, but rather is the fact that the jackpots have not yet been *won* by anyone. The winning handle pull, in our view, is a "condition precedent" to the creation of a fixed liability. Remote contingencies like bankruptcy, which might serve to divest respondent of its obligation on liabilities once they have become fixed, are properly regarded as "conditions subsequent." It is well settled that conditions of the latter sort do not preclude accruals under the "all events" test, and we are not contending otherwise. We mentioned the bankruptcy scenario (Pet. 10-11) merely as a way of illustrating, in a graphic way, that respondent has no present liability at all. The point is not that respondent has creditors whose *claims might be discharged* in bankruptcy. The point is that no slot machine player could even *assert a claim* against respondent in bankruptcy unless and until he had won a jackpot.

c. Respondent notes correctly that this case concerns the proper timing of deductions, not the intrinsic propriety of the deductions themselves, and that, if it were permitted to accrue deductions for jackpots that nobody ever wins, it would have to recognize a corresponding amount of income in some later tax year (Br. in Opp. 4, 11-12). But to suggest, as respondent seems to do, that these considerations diminish the significance of the issue is to ignore the time value of money. A deduction today is worth more than a deduction one, five, or twenty years from now; if the accruals involved are sufficiently large, their time value alone, as this case demonstrates (Pet. 5, 15-16), can involve huge amounts of revenue. Disputes about the "all events" test *necessarily* concern the proper time for accruing income and deductions. It is precisely because large sums hinge on the outcome that "all events" questions are so frequently and so fervently litigated.

d. Finally, respondent contends that "[t]he Federal Circuit in this case and the Ninth Circuit in *Nightingale* purported to apply the same applicable tax law," and asserts that the two cases thus involve a mere "disagreement over [the] facts" unworthy of further review (Br. in Opp. 6, 21). It is of course true that both circuits began with the same theoretical formulation of the "all events" test, which, in its general terms, has remained unchanged since it was enunicated by this Court sixty years ago. *United States* v. *Anderson*, 269 U.S. 422 (1926). The question here, as in most "all events" cases, concerns not the formulation of the test, but its application to a particular species of facts — the determination, in other words, of which events are the relevant and dispositive events for federal tax purposes. Everyone agrees that the facts of *Nightingale* and the facts of this case, which were stipulated, are substantially identical. Since two courts of appeals have reached contradictory results purporting to apply the same test to the same facts, it is obvious that one of those courts has misapprehended the governing legal standard. That error is an error of law, and starkly indicates that further clarification of that standard by this Court is needed in this much litigated area of tax law.

For these reasons and for the reasons set forth in our petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

CHARLES FRIED
Solicitor General

NOVEMBER 1985

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